Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In re	)	
	)	
Ways To Further Section 257 Mandate and	)	MB Docket 04-228
To Build on Earlier Studies	)	DA 04-1690

COMMENTS

THE STROUD COMPANIES

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SUMMARY

In these comments, Joseph A. Stroud, a minority, and the Stroud Companies ("Stroud"), a minority-owned and controlled business that through affiliates holds Commission authorizations, demonstrates that combating discrimination in the communications industry is a compelling interest. Stroud then offers two narrowly tailored programs that meet this interest. As such, Stroud has proposed reforms that are constitutionally permissible, particularly in light of the Supreme Court's recent decisions in Grutter v. Bollinger and Gratz v. Bollinger.

Racial and ethnic minorities have been the victims of repeated discrimination in capital markets, and numerous studies filed with or commissioned by the FCC have documented this fact. In particular, they have demonstrated that lack of access to capital explains minorities' less successful performance in FCC auctions. Other governmental bodies have also documented widespread discrimination in access to credit. To the extent that the FCC passively participates in this system of discrimination, it has a compelling interest in ending such practices.

As discussed in more detail in these comments, Stroud proposes that the FCC permit businesses to apply for certification as socially disadvantaged businesses ("SDBs") if they are owned by socially disadvantaged individuals under

one of three tests set forth in legislation recently proposed by Senator McCain. In addition to establishing this definitional framework, Stroud urges the FCC to continue to encourage Congress to enact tax deferral legislation to benefit FCC regulatees that enter into transactions with SDBs certified under the definition. Stroud also urges the FCC to coordinate with the Department of Agriculture to develop a program of federally guaranteed loans and federally sponsored grants that would be available for SDBs that provide telephone service in rural areas.

Finally, Stroud demonstrates that these proposals would be narrowly tailored to meet the FCC's compelling interest in combating discrimination in telecommunications. SDB status would be conferred based on the FCC's individualized review of each certification request. The program would not impermissibly burden non-favored racial or ethnic groups. Stroud also recommends time limits on any such program's duration.

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COMMENTS

Joseph A. Stroud and the Stroud Companies ("Stroud") hereby submit their comments in the above-referenced proceeding which was commenced to study constitutionally permissible ways to further the mandates of Section 257 of the Telecommunications Act of 1996, 47 U.S.C. § 257, and Section 309(j) of the Communications Act of 1934, 47 U.S.C. § 309(j).[1] The Commission initiated this proceeding to explore further steps that would advance these statutory objectives in a constitutionally permissible manner, particularly in light of the Supreme Court's recent decisions in Grutter v. Bollinger, 539 U.S. 306 (2003), and Gratz v. Bollinger, 539 U.S. 244 (2003).

Stroud is a minority-owned and controlled business that is interested in all aspects of the telecommunications industry and is currently, through affiliates, a

[1] "Media Bureau Seeks Comment on Ways To Further Section 257 Mandate and To Build on Earlier Studies," FCC Public Notice, DA 04-1690, released June 15, 2004. Section 257 directs the FCC to identify and eliminate market entry barriers for small telecommunications businesses. Section 309(j) requires the FCC to further opportunities in the allocation of spectrum-based services for small businesses and businesses owned by women and minorities. The comment deadline in this proceeding was extended through today by FCC Public Notice, DA 04-2906, released September 8, 2004.

Commission licensee. As such, Stroud has a strong interest in any FCC proceeding directed toward enhancing opportunities for minorities in the communications industry. As part of its review, the FCC should encourage diversity of ownership in all communications sectors as well as further diversity in employment and contracting and outsourcing activities.

The comments below demonstrate not only that the FCC has a compelling interest in furthering diversity but also set forth a proposal which, as judicial precedent requires, is narrowly tailored to meet this goal in the provision of telecommunications services. Stroud urges the FCC to give serious consideration to adoption of the specific proposal set forth below and also to take steps to advance diversity in all communications sectors.

I. The Constitution Permits Race-Conscious Measures That Are Narrowly Tailored To Serve a Compelling Interest.

The Fifth Amendment to the United States Constitution permits the Commission to implement race-conscious measures to benefit socially disadvantaged entrepreneurs if its program withstands strict scrutiny. See Adarand Constructors, Inc. v. Pena, 515 U.S. 200, 227 (1995) ("Adarand I"). Consequently, the Commission may design a plan that is narrowly tailored and serves a compelling interest. See Gratz v. Bollinger, 539 U.S. 244, 270 (2003). Although this standard is demanding, it is not unattainable. See Grutter v. Bollinger, 539 U.S. 306, 326 (2003) ("Strict scrutiny is not strict in theory, but fatal in fact.")

(internal quotations omitted). The Commission can satisfy the strict scrutiny test articulated in Adarand I if it adopts a well-crafted program designed to benefit socially disadvantaged entrepreneurs.

The Commission must satisfy the two-part test set forth by the Supreme Court in Adarand I. First, the Commission must identify with specificity the compelling interest it seeks to serve. See City of Richmond v. J.A. Croson Co., 488 U.S. 469, 498-500 (1989). The Court requires the Commission to compile evidence providing it with a "strong basis" for concluding that its interest is compelling and that remedial action is necessary. Id. at 500. Second, any race-based program that the Commission employs must closely fit the compelling interest that it seeks to reach. See Grutter, 539 U.S. at 333. A solution that is either over- or underinclusive is not narrowly tailored and fails strict scrutiny. See Croson, 488 U.S. at 498-99.

II. Combating Discrimination in the Telecommunications Industry Is a Compelling Interest.

The Commission has a compelling interest in not facilitating a system of racial exclusion created by capital market discrimination. The Supreme Court has declared that the government has a compelling interest in not serving as a "passive participant" in a system of racial exclusion. See Croson, 488 U.S. 492. Accordingly, the Commission may implement race-conscious measures designed to prevent it from perpetuating the effects of private industry discrimination. See

Adarand Constructors, Inc. v. Slater, 228 F.3d 1147, 1165 (10th Cir. 2000), cert. denied, 534 U.S. 103 (2001) ("Adarand VII"). Even though the Commission may have never discriminated directly against minority applicants, it is entitled to take affirmative steps to ensure that it does not award licenses in a manner that perpetuates or furthers private prejudices. See id. at 1164.

Racial and ethnic minorities have been the victims of repeated discrimination in the capital markets. Over the last few years, the Commission has received several studies demonstrating that this discrimination handicaps minority entrepreneurs attempting to enter the telecommunications industry. See, e.g., William D. Bradford, Discrimination in Capital Markets, Broadcast/Wireless Spectrum Service Providers and Auction Outcomes (2000); Ivy Planning Group, LLC, Whose Spectrum is it Anyway? Historical Study of Market Entry Barriers, Discrimination and Changes in Broadcast and Wireless Licensing 1950 to Present (2000) (hereinafter "Whose Spectrum is it Anyway?"). In addition, the agency has commissioned a study suggesting that lack of access to capital explains why minorities are less successful in FCC auctions. See Ernst & Young LLP, FCC Econometric Analysis of Potential Discrimination Utilization Ratios for Minority- and Women-Owned Companies in FCC Wireless Spectrum Auctions 12 (2000). Indeed, it is well established that minorities face widespread discrimination in the capital markets. See, e.g., Proposed Reforms to Affirmative Action in Federal

Procurement, 61 Fed. Reg. 26042, 26052 (May 23, 1996) (DOJ proposal citing studies and congressional hearings documenting that "widespread discrimination, especially in access to financial credit, has been an impediment to the ability of minority-owned business to have an equal chance at developing in our economy"); see also Adarand VII, 228 F.3d at 1169 (citing studies and noting that "[t]he government's evidence is particularly striking in the area of the race-based denial of access to capital"). These materials provide the Commission with a strong basis for concluding that socially disadvantaged entrepreneurs in the telecommunications industry have been victims of discrimination and that the Commission must combat this through establishment of affirmative programs.

To the extent the Commission passively participates in this system of discrimination, it has a compelling interest in ending such practices. The telecommunications industry is extremely capital intensive. Only well-financed companies win FCC auctions or acquire FCC-regulated businesses. Minority-owned businesses, therefore, are at a distinct disadvantage because discrimination hinders their ability to raise capital and thus establishes a significant barrier to entry. The Commission's regulatory policies passively support this discrimination and continue to hinder socially disadvantaged entrepreneurs' ability to enter the telecommunications industry. For example, the Commission awards most of its auctionable spectrum to the highest bidder, and it approves applications to transfer

licenses to other well-financed entities. Nevertheless, with Commission recognition and identification of its inadvertent contribution to the discrimination within the telecommunications industry, it has the authority to effectively combat such discrimination. See Croson, 488 U.S. at 492.

III. Description of Stroud's Proposed Program.

Stroud proposes that the Commission implement a program to benefit socially disadvantaged entrepreneurs who continue to suffer from discrimination. In particular, Stroud models its proposal on Sections 8(a) and 8(d) of the Small Business Act of 1958[2] and the Small Business Administration's ("SBA") implementing regulations,[3] which both the United States Courts of Appeals for the Eighth and Tenth Circuits have recently upheld. See Sherbrooke Turf, Inc. v. Minn. Dept. of Transp., 345 F.3d 964 (8th Cir. 2003); Concrete Works of Colo. v. City & County of Denver, 321 F.3d 950 (10th Cir.), cert. denied, 124 S.Ct. 556 (2003). See also Adarand VII.

Stroud proposes that the Commission permit businesses to apply for certification as socially disadvantaged businesses ("SDBs") if they are owned by socially disadvantaged individuals in a manner that complies with one of the three tests in the Telecommunications Ownership Diversification Act of 2003, a bill

[2] See Pub. L. No. 85-536, 72 Stat. 384 (codified at 15 U.S.C. §§ 631 et. seq.).
[3] See 13 C.F.R. Part 124 (2004).

introduced by Senator McCain.[4] The Commission should define socially disadvantaged individuals as follows:

> Socially disadvantaged individuals are those who, as individuals or because of their membership in a class, have been subjected to racial or ethnic prejudice or cultural bias within the telecommunications industry or the funding capital markets because of their identity as members of groups and without regard to their individual qualities. The social disadvantage must stem from circumstances beyond the individual's control.[5]

Furthermore, the Commission's definition should include a rebuttable presumption that the following individuals are socially disadvantaged: African Americans, Hispanic Americans, Native Americans, Asian or Pacific Americans, and any other group of individuals that the Commission may from time to time designate as similarly disadvantaged.[6] The Commission should then individually review each application for certification as an SDB and determine which entities qualify on a

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[4] Under this proposal, an entity can qualify as an SDB in three different ways:

> 1) 30-Percent Test: If socially disadvantaged individuals collectively own at least thirty percent of the equity of the entity and control more than fifty percent of the voting interests; or
>
> 2) 15-Percent Test: If socially disadvantaged individuals collectively own at least fifteen percent of the equity and control more than fifty percent of voting interests, and no other person owns more than a twenty-five percent equity interest; or
>
> 3) Publicly-Traded Corporation Test: If the entity is a publicly traded corporation and socially disadvantaged individuals control more that fifty percent of the voting stock in the corporation.

See Telecommunications Diversification Act of 2003, S. 267, 108th Cong. § 3(f)(6) (2003).

[5] Stroud developed this definition by slightly modifying the SBA's definition of socially disadvantaged individuals at 13 C.F.R. § 124.103(a) (2004). The Tenth Circuit upheld this definition in Adarand VII. See Adarand VII, 228 F.3d at 1155.

[6] SBA regulations include a similar rebuttable presumption at 13 C.F.R. § 124.103(b). The United States Court of Appeals for the Eighth Circuit has concluded that a rebuttable

case-by-case basis. To ensure that SDBs do not retain certification indefinitely, the Commission should periodically require SDBs to file applications to renew their status.

Once the Commission creates this general framework for assisting SDBs, it can develop and implement specific programs to further its goals. If the Commission certifies an applicant as an SDB, the applicant would then become eligible to participate in Commission sponsored initiatives and receive certain benefits. In addition, non-SDBs that do business with SDBs could also become eligible for certain FCC benefits. As described below, Stroud requests that the Commission work to implement two proposals to aid socially disadvantaged entrepreneurs in the rural telephone industry: actively encouraging enactment of tax deferral legislation and implementing government sponsored programs providing capital for SDBs.[7]

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presumption that certain individuals are economically or socially disadvantaged complies with the Constitution. See Sherbrooke, 345 F.3d at 973.

[7] The Commission could utilize this framework to implement additional programs to aid socially disadvantaged entrepreneurs in other segments of the telecommunications industry, including the broadcast, cable, and wireless industries. In fact, in Prometheus Radio Project v. FCC, 373 F.3d 372, 428 n.70 (3rd Cir. 2004), the United States Court of Appeals for the Third Circuit suggested that the FCC consider implementing an SDB-based waiver when reviewing applications to transfer grandfathered broadcast clusters.

A. The Commission Should Continue To Encourage Congress To Enact Tax Deferral Legislation To Benefit FCC Regulatees That Enter into Transactions with SDBs.

The Commission should continue to encourage Congress to enact legislation authorizing the Commission to issue tax deferral certificates to companies that sell telecommunications properties to SDBs. Until its repeal in 1995, the tax certificate program was the most effective means of advancing participation by SDBs in the telecommunications industry. See Whose Spectrum is it Anyway?, supra, at 106. The program provided tax incentives to companies that sold qualifying property to minority owned businesses, and consequently it encouraged FCC licensees to seek out and do business with minority-owned firms.

Once tax deferral legislation is adopted, the Commission should administer the reenacted tax deferral standards within the framework of its proposal to certify SDBs. The Commission would grant a tax certificate to any FCC regulatee that sells a qualifying telecommunications property to an SDB. The tax certificate would entitle the seller to defer capital gains taxation, provided that the seller reinvests the proceeds from the sale in "like kind" property within two years. If Congress authorizes the Commission or another government agency or department to administer a tax deferral program, SDBs will see immediate benefits because communications companies again will seek out SDBs when contemplating future transactions.

B. The Commission Should Coordinate with the Department of Agriculture To Develop a Program of Federally Guaranteed Loans and Federally Sponsored Grants for SDBs That Own Rural Telephone Properties.

Access to capital is one of the biggest obstacles SDBs face in acquiring telecommunications companies. The Commission should take steps to level this financial playing field. Currently, rural telephone companies can request federal assistance for raising capital from the Department of Agriculture ("USDA"), but despite the discrimination SDBs encounter in the private capital markets, the USDA does not offer them any additional assistance. The Commission should coordinate with the USDA to develop opportunities for SDBs to have greater access to the USDA programs.

Through its Rural Telephone Bank ("RTB") and the Rural Utilities Service ("RUS"), the USDA offers different opportunities for rural telephone companies to acquire capital for expansion or start-up projects.[8] The RTB and RUS offer low-interest loans, zero-interest loans, and grants for rural telephone companies. In addition, they sometimes act as guarantors for loan agreements between rural telephone companies and private banks.

The Commission should coordinate with USDA to enable SDBs to take greater advantage of these programs. In particular, when reviewing loan or grant applications, the USDA should consider the applicant's FCC certification as an

SDB a "plus factor" when evaluating whether to extend funds for a project. By working with the USDA to facilitate access to capital, the Commission can directly remedy one of the biggest impediments that SDBs must overcome.

IV. Stroud's Proposals Are Narrowly Tailored To Serve the Commission's Compelling Interests.

Stroud's proposals satisfy the Supreme Court's requirement that race-conscious solutions must be narrowly tailored. Identifying and serving a compelling interest does not end the Commission's task. The Commission must design its race-conscious solutions narrowly, so they closely fit the compelling interest that it seeks to reach. See Grutter, 539 U.S. at 333. The Supreme Court has announced that any race-conscious measure must meet several standards to be narrowly tailored. First, the Commission must individually review each request for race-based benefits, see Grutter, 539 U.S. at 336-37; Gratz, 539 U.S. at 271; Gratz, 539 U.S. at 276 (O'Connor, J., concurring) (discussing the importance of individualized review), and as the FCC reviews each application, race may not be a singly decisive factor. See Gratz, 539 U.S. at 272. Second, the program may not unduly burden members of a nonfavored racial or ethnic group, and, third, the race conscious measures may only last as long as they are necessary. See Grutter, 539 U.S. at 339, 342.

[8] See generally 7 C.F.R. Parts 1600 and 1700 (2004).

A. Individualized Review Ensures That the Program Is Flexible So It Achieves Its Articulated Goals.

Narrow tailoring requires flexibility, and that is the hallmark of Stroud's proposal. It does not automatically aggregate all individuals into one group or another. Rather, every individual or entity regardless of racial or ethnic background has the opportunity to participate and demonstrate qualification under the Commission's definition of social disadvantage. The Commission's individual review of each application for certification as an SDB ensures that all decisions will be made on a case-by-case basis and that no applicant will be insulated from Commission scrutiny.

Under Stroud's proposal, although the Commission presumes that members of certain racial and ethnic groups are socially disadvantaged, race will not be a determinative factor. If, in light of all the circumstances including the particular industry and geographic region which the applicant seeks to serve, the Commission determines that the applicant has overcome its social disadvantage or never was the victim of discrimination, the Commission should deny the request for certification. Furthermore, members of groups who are not presumed socially disadvantaged may still seek certification as an SDB and demonstrate that they otherwise qualify. For example, an individual who has faced discrimination because he is from rural Appalachia may be able to qualify as socially disadvantaged regardless of race or ethnicity. Both the United States Courts of Appeals for the Eighth and Tenth

Circuits have determined that a similar presumption that the SBA employs is consistent with the Fifth Amendment because a meaningful individualized review is provided. See Sherbrooke, 345 F.3d at 973; Adarand VII, 228 F.3d at 1183.

B. The Program Does Not Impermissibly Burden Nonfavored Racial or Ethnic Groups.

Individualized review prevents Stroud's proposal from burdening any particular racial or ethnic group. Any individual, regardless of race or ethnicity, who has suffered from discrimination can seek FCC certification as an SDB. No group is disfavored or burdened because the program treats each applicant as an individual and not as member of a racial or ethnic group. Cf. Grutter, 539 U.S. at 341 (declaring that the University of Michigan Law School's admissions policy does not unduly harm nonminority applicants because the school evaluates each application individually). Furthermore, both the United States Courts of Appeal for the Federal and Tenth Circuits have agreed that similar race-conscious certification programs do not burden nonminorities. See Rothe Devel. Corp. v. U.S. Dept. of Defense, 262 F.3d 1306, 1331 (Fed. Cir. 2001) (agreeing that a similar Department of Defense program does not "unduly impact on the rights of third parties"); Adarand VII, 228 F.3d at 1183 (noting that the SBA's race-conscious program does not unduly burden nonminorities because it includes provisions for their participation).

C. The Program Includes Internal Limitations on Its Duration.

Unlike the program that the Supreme Court criticized in Croson, Stroud's proposal includes an internal time limitation. See Croson 488 U.S. at 498. SDBs must periodically renew their status. If the Commission determines that the entity no longer suffers from discrimination, it will reject its SDB renewal application. Accordingly, race-based preferences will naturally phase out as they are no longer necessary. Cf. Grutter, 539 U.S. at 343 (anticipating that race-based preferences in law school admissions programs will no longer be necessary in twenty-five years). Stroud's proposal would sunset when SDBs no longer face discrimination in the capital markets. As such, it is narrowly tailored to fit the Commission's compelling interest.

IV. Conclusion.

The FCC has a compelling interest in correcting past discrimination in the communications field. The proposal put forth above does so in a constitutionally permissible manner. Accordingly, Stroud respectfully urges the FCC to act promptly to initiate the program it has proposed.

Respectfully submitted,

THE STROUD COMPANIES

By _____
Joseph A. Stroud

Date: October 12, 2004